

OVERVIEW OF THE 2006-07 BUDGET BILL

Senate Bill 1129

As Introduced

Senate Committee on Budget and Fiscal Review
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Dear Colleague:

I am pleased to forward a copy of the *Overview of the 2006-07 Budget Bill*, which has been prepared by the staff of the Senate Budget and Fiscal Review Committee.

In the first section, we provide an overview of the state's fiscal condition. The next section, entitled "Budget Highlights," is organized by budget subcommittee, and details the budget proposals for most departments and agencies. If you are looking for a specific department or agency, there is an index at the end of the "budget highlights" section.

In the Appendix, we include a working timeline for completing the budget and a list of budget committee consultants and their respective areas of expertise.

If you have questions, please do not hesitate to contact me.

Sincerely,

WESLEY CHESBRO
Chair

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SUMMARY OVERVIEW

On January 10, the Governor presented his proposed 2006-07 budget. Spending from all funds (General Fund, special funds, and bond funds) totals \$125.6 billion. The Governor's proposed budget contains a total of \$98.6 billion in available General Fund resources (this is comprised of approximately \$7 billion in prior-year carry forward balances and \$91.5 billion in resources accrued in the budget year). The budget proposes \$97.9 billion in General Fund expenditures, and a \$153 million reserve. The budget also includes a \$460 million reserve in the Budget Stabilization Account pursuant to Proposition 58 (passed in March 2004).

Overall, General Fund revenues are estimated to be \$9.2 billion greater than what was projected when the current-year budget (SB 77 – Chapter 38, Statutes of 2005) was passed in July. This estimate includes increases of \$2.3 billion for the 2004-05 fiscal year, \$3.2 billion for the 2005-06 budget year, and \$3.7 billion for the 2006-07 proposed budget year.

The Governor proposes to increase General Fund expenditures by a total of \$7.6 billion above the revised 2005-06 level. According to the Department of Finance (DOF), \$3.5 billion of the expenditure increases results from new policy decisions -- such as increasing discretionary Proposition 98 funding by \$1.7 billion above the administration's estimated guarantee level and repaying a portion of a Proposition 42 loan (\$920 million) a year earlier than required -- and approximately \$4.1 billion of the total expenditure increase is required under current law for items such as caseload growth and debt service on bonds already sold.

However, there are potential budgetary threats in excess of \$1 billion General Fund, which the proposed budget does not address at the present time; the Legislative Analyst's Office (LAO) has raised at least four. First, the budget does not contain funding for any new employee collective bargaining agreements; 18 bargaining unit contracts expire as of July 1, 2006. Second, there are various court orders and lawsuits that may have a significant but unknown impact on the General Fund -- particularly in the area of Corrections and Rehabilitation, as well as within the CalWORKs program. Third, according to the LAO, the state will likely need to address the issue of additional unfunded local mandate costs. And finally, major funding changes currently pending at the federal level will likely have a significant negative impact on the state General Fund for a number of years.

Last, but not least, the state continues to be faced with a structural deficit between on-going revenues and expenditures, also referred to as an operating deficit. While progress has been made to narrow the gap, cursory analysis of the proposed budget indicates that the state will end 2006-07 with an operating deficit in excess of \$4 billion, with the gap widening to between \$6 billion and \$7 billion by the end of 2007-08. And, DOF assumes, as part of their "Strategic Growth Plan" to eliminate the remainder of the structural deficit within one to two years; the Legislature awaits details on how this will be accomplished.

General Fund Summary

Revenues: The Governor's budget estimates General Fund revenues and transfers to be approximately \$91.5 billion, an increase of \$3.8 billion, or 4.4 percent, above the revised 2005-06 estimate of \$87.7 billion. Total resources available, in 2006-07, from all sources (including a carry forward balance of \$7 billion from 2005-06) are estimated at \$98.6 billion.

Expenditures: The budget proposes General Fund expenditures of \$97.9 billion in 2006-07. This is an increase of \$7.6 billion, or 8.4 percent, over the revised 2005-06 figure of \$90.3 billion.

| Proposed 2006-07 General Fund Summary (in millions) | | |
|--|----------------------------|-----------------------------|
| | Revised 2005-06 | Proposed 2006-07 |
| PRIOR YEAR BALANCE | \$9,634 | \$7,031 |
| Revenues and transfers | 87,691 | 91,545 ^a |
| TOTAL RESOURCES AVAILABLE | \$97,325 | \$98,576 |
| Non-Proposition 98 Expenditures | \$53,983 | \$57,446 ^a |
| Proposition 98 Expenditures | <u>36,311</u> | <u>40,456</u> |
| TOTAL EXPENDITURES | \$90,294 | \$97,902 |
| FUND BALANCE | \$7,031 | \$674 |
| Encumbrances | \$521 | \$521 |
| Special Fund for Economic Uncertainties | \$6,510 | \$153 |
| BUDGET STABILIZATION ACCOUNT (BSA) | -- | \$460 |
| TOTAL AVAILABLE RESERVE | \$6,510 | \$613 |

^a A total of \$920 million will be transferred to the BSA consistent with Proposition 58. Of this amount, one-half (\$460 million) will remain in the BSA for future purposes (shown as a reduction in revenue) and one-half will be transferred to accelerate the retirement of Economic Recovery Bonds (shown as an increase in expenditures).

Proposed 2006-07 Budget -- Major General Fund Changes

- Provides total Proposition 98 funding of \$54.3 billion (\$40.5 billion General Fund / \$13.9 billion in property taxes). This is a \$4.3 billion, or 8.7 percent, increase over the revised 2005-06 estimate.
 - ✓ The Administration indicates \$2.2 billion will be used to meet the Proposition 98 minimum funding guarantee.
 - ✓ \$2.1 billion is provided above the proposed minimum guarantee, which includes a discretionary \$1.7 billion for early repayment of the Proposition 98 maintenance factor (which is then expended on various items) and \$428 million for after-school programs (Proposition 49).
- Includes \$131 million to buy out proposed student fee increases at both UC and CSU. However, the budget eliminates all General Fund for both UC (\$17.3 million) and CSU (\$7 million) academic preparation programs.
- Proposes various adjustments to the California Work Opportunity and Responsibility to Kids (CalWORKs) program that result in a net decrease of \$199 million.
- Proposes to delay the 2007 federal SSI/SSP cost-of-living adjustment (COLA) an additional 15 months, from April 2007 to July 2008. This would result in a General Fund savings of \$48 million in the budget year and \$185 million in 2007-08.
- Proposes an increase of \$1.2 billion in various health and human services programs, which includes provider rate increases for certain developmental disability service programs and an expansion of the Healthy Families program.
- Increases funding for Corrections and Rehabilitation by \$423 million. Of this amount, \$335 million is primarily for population and workload increases.
- Provides a net increase of \$135 million for programs within the Resources and Environmental Protection area.
- Contains an increase of \$224 million for the Judicial Branch, primarily attributable to a growth factor of \$123 million and restoration of one-time reductions of \$58 million.
- Provides for the full funding of Proposition 42 at \$1.4 billion. In addition, the budget includes a partial prepayment of \$920 million for a past loan, with the balance (\$430 million) due in 2007-08.
- Transfers \$920 million to the Budget Stabilization Account (BSA).
- Assumes \$258 million in unspecified savings and unallocated reductions.

Total General Fund Spending Concentrated in Four Areas

Four policy areas account for approximately 90 percent of General Fund spending contained in the Governor's Budget. The table below identifies the relative spending in these areas. Specifically, in the 2006-07 budget:

- K-14 Education (which includes funding for community colleges) receives \$40.5 billion, accounting for 41 percent of the General Fund spending;
- Health and Human Services receives \$28.5 billion, accounting for 29 percent of the total;
- Higher Education (UC, CSU and Student Aid Commission) receives \$10.4 billion, accounting for almost 11 percent of the total; and
- Corrections and Rehabilitation (formerly Youth and Adult Corrections) receives \$8 billion, accounting for 8.2 percent of the total.

Proposed 2006-07 General Fund Expenditures (in millions)

| Major Program Area | Revised 2005-06 | Proposed 2006-07 | Year-to- Year % Change |
|--|--------------------|---------------------|------------------------------|
| Education – Proposition 98 (K-12 / Community Colleges) | \$36,311 | \$40,456 | 11.4% |
| Health and Human Services | 27,237 | 28,450 | 4.5% |
| Higher Education (UC/CSU/Other) | 9,517 | 10,413 | 9.4% |
| Corrections and Rehabilitation (formerly Youth and Adult Corrections) | 7,612 | 8,038 | 5.5% |
| All Other | <u>9,617</u> | <u>10,545</u> | <u>9.6%</u> |
| TOTAL | \$90,294 | \$97,902 | 8.4% |

**Proposed 2006-07
General Fund Revenue
By Source
(in millions)**

| Source | Revised 2005-06 | Proposed 2006-07 | Year-to- Year |
|---------------------|--------------------|---------------------|-------------------|
| | | | Percent Change |
| Personal Income Tax | \$45,493 | \$48,716 | 7.1% |
| Sales Tax | 27,184 | 28,295 | 4.1% |
| Corporation Tax | 9,621 | 10,024 | 4.2% |
| Other | <u>5,393</u> | <u>4,970</u> | <u>-7.8%</u> |
| TOTAL | \$87,691 | \$92,005 | 4.91% |

Infrastructure Bond Proposal

In his State of the State address on January 5 and as part of the proposed budget, the Governor presented an infrastructure proposal, known as the Strategic Growth Plan. The plan lays out the initial 10 years of a 20-year objective to focus on the state's infrastructure needs in the areas of transportation, K-12 and higher education, flood control and water supply, public safety, the courts, and other miscellaneous program areas.

According to the Administration, phase one (2006-2014) of the plan projects more than \$220 billion in infrastructure expenditures -- of this amount, \$68 billion will be financed with General Obligation (GO) bonds, \$96 billion would be from existing resources such as state and federal gas taxes and vehicle weight fees, and \$59 billion would be from new resources such as private investment and future federal funds. In addition, as noted previously, the administration assumes that the state will also eliminate the remainder of the structural deficit within the next one to two years.

The Governor proposes that the Legislature approve the entire 10-year plan as a single package; however, the GO bonds would be put before the voters of California over a series of elections between 2006 and 2014. The table below shows the election cycle for the GO bonds by program area for the first 10 years. In addition to the bond package, the Administration is seeking two constitutional amendments. The first amendment would eliminate the state's ability to suspend Proposition 42. The second would cap debt service payments to no more than 6 percent of General Fund expenditures in any fiscal year.

The Legislature has convened a joint conference committee to address the fiscal/policy implications of the bond proposals currently proposed by both the Governor and the Legislature. Policy issues will be analyzed and addressed through the committee process with reports from each caucus presented to the conference committee for resolution and action. Policy committee hearings are scheduled to begin in late January. According to the Secretary of State, any measure chaptered after March 10 will be on the November 2006 ballot.

| General Obligation (GO) Bonds By Election Year (in billions) | | | | | | |
|---|---------------|---------------|---------------|---------------|---------------|---------------------------|
| Program Area | 2006 | 2008 | 2010 | 2012 | 2014 | 10-year Totals |
| Transportation / Air Quality | \$ 6.0 | \$6.0 | \$ -- | \$ -- | \$ -- | \$12.0 |
| K-12 & Higher Education | 12.4 | 4.2 | 7.7 | 8.7 | 5.0 | 38.0 |
| Flood Control and Water Supply | 3.0 | -- | 6.0 | -- | -- | 9.0 |
| Public Safety | 2.6 | -- | 4.2 | -- | -- | 6.8 |
| Courts & Other Public Services | | | | | | |
| Infrastructure | <u>1.2</u> | -- | <u>1.0</u> | -- | -- | <u>2.2</u> |
| TOTALS | \$25.2 | \$10.2 | \$18.9 | \$ 8.7 | \$ 5.0 | \$68.0 |

Status of Revised Current-Year (2005-06) Budget

On July 7, 2005, the Legislature passed SB 77, the 2005 Budget Act (Chapter 38, Statutes of 2005) and companion legislation, SB 80 (Chapter 39, Statutes of 2005), that revised various items to the main budget. In enacting these bills, the Legislature met its Constitutional obligation to pass a balanced budget. The table below broadly summarizes the state General Fund for fiscal years 2004-05 and 2005-06, as revised in the proposed 2006-07 Governor's Budget.

| Revised 2005-06 General Fund Summary (in millions) | | |
|---|-------------------------------------|-----------------------------------|
| | 2004 Budget (Actual) | 2005 Budget (Est.) |
| | <u>2004-05</u> | <u>2005-06</u> |
| Prior-Year Balance | \$ 7,228 | \$ 9,634 |
| Revenues and Transfers | 82,209 | 87,691 |
| Total Resources Available | 89,438 | 97,325 |
| Expenditures | 79,804 | 90,294 |
| Fund Balance | 9,634 | 7,031 |
| Reserves: | | |
| Liquidation of Encumbrances | -521 | -521 |
| Economic Uncertainties | \$9,112 | \$6,510 |

Broad Overview of 2005 Budget, as Revised

- The 2005 Budget Act (SB 77) provided a balanced budget as required by the state Constitution.
- Total revised General Fund resources are estimated at \$97.3 billion, while estimated expenditures are approximately \$90.3 billion. (The total budget for all funding sources was projected at \$117.3 billion.)
- Due to stronger-than-anticipated revenue growth over the 2004-05 and 2005-06 fiscal years, the state will end 2005-06 with a General Fund reserve of \$6.5 billion.
- The budget did not include any general tax increases, but is premised on some fee increases particularly in the area of higher education.
- The budget, at the time of passage, did not rely on assumed unachievable savings, solutions, or federal funding.
- Additional details on specific actions taken in the 2005-06 Budget can be found in the Senate Budget Committee's *Final Action Report, a Summary of the 2005 Budget Act*.